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INTERNATIONAL MONETARY FUND QUOTA INCREASE

HEARING

BEFORE THE

SUBCOMMITTEE ON INTERNATIONAL FINANCE AND MONETARY POLICY

OF THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDRED SECOND CONGRESS

FIRST SESSION

ON

PROPOSED LEGISLATION TO AUTHORIZE THE U.S. PARTICIPATION IN THE QUOTA INCREASE OF THE INTERNATIONAL MONETARY FUND [IMF]

JUNE 25, 1991

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INTERNATIONAL MONETARY FUND QUOTA INCREASE

TUESDAY, JUNE 25, 1991

U.S. SENATE, COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS, SUBCOMMITTEE ON INTERNATIONAL FINANCE AND MONETARY POLICY,

Washington, DC.

The committee met, pursuant to notice, at 10:08 a.m., in room SD–538 of the Senate Dirksen Office Building, Senator Paul S. Sarbanes (chairman of the subcommittee) presiding.

OPENING STATEMENT OF SENATOR SARBANES

Senator SARBANES. The subcommittee will come to order.

I'm pleased to welcome this morning to testify before the Subcommittee on International Finance and Monetary Policy, the able Under Secretary of the Treasury for International Affairs, David Mulford.

The subject of this morning's hearing is the request by the administration for an authorization by Congress of a contribution by the United States to the IMF, International Monetary Fund, quota increase.

Congress last provided such a quota increase for the International Monetary Fund in 1983, 8 years ago. Under the articles of agreement of the International Monetary Fund, the Fund must review the level of its quota contributions every 5 years to determine whether they are adequate to meet the expected demand for loans from the Fund.

The United States resisted efforts within the International Monetary Fund to seek a quota increase in 1988 and in 1989, on the grounds that the Fund has sufficient resources.

Last June, however, the 9th general review of quotas by the International Monetary Fund was completed and the United States voted in favor of seeking a 50-percent increase in quotas. This 50-percent increase is scheduled to go into effect by December 31, 1991, the end of this year, provided that member nations accounting for more than 85-percent of the IMF's quotas agree to the increase.

Since the United States has a voting power of 19 percent in the IMF, failure on the part of the United States to approve the quota increase would prevent it from going forward, since obviously, the 85-percent figure could not be reached without the support of the United States.

Section 5 of the Bretton-Woods Act of 1945 requires that the U.S. participation in any quota increase must be approved by the Congress. The IMF currently has resources of approximately $130 billion and is seeking a quota increase of approximately one-half that amount. Since the United States has 19.6 percent of the IMF quota, the U.S. contribution to this increase would be approximately $12 billion. Such a contribution would require both an authorization and an appropriation from the Congress.

But it is my understanding that the way it is scored for budget purposes, that the payment of the quota contribution does not have an impact on the U.S. budget deficit. This is because under congressional budget procedures, a quota contribution is considered an asset, much as a bank account is considered an asset.

When the U.S. pays its quota increase, it is considered that the United States has received an asset in exchange for its quota contribution.

Any fund use of U.S. quota resources is offset by the receipt by the United States of a liquid interest bearing claim on the Fund. Therefore, in budgetary terms, an exchange of assets is considered to have occurred and no new net budget outlay is regarded as having taken place.

Nevertheless, the subcommittee will wish to review carefully this morning the rationale for the quota increase request. In this regard, it would be helpful if the administration could review for us the anticipated expenditures by the International Monetary Fund for the remainder of this year and next year, and lay out the likely financial condition of the Fund which provides the rationale or the justification for a quota increase.

It also would be worthwhile to review how the International Monetary Fund expenditures might be allocated. For example, how much assistance will be provided to Eastern Europe, to Latin America, through the debt strategy and for other major fund purposes and objectives.

Finally, the subcommittee will wish to review the outcome of the meeting of the G–7 finance ministers this past weekend. Press reports following the meeting indicates that the G–7 countries may be prepared to offer an associate membership, not a full membership, but an associate membership, in the International Monetary Fund for the Soviet Union, as an action to be taken at the group's summit conference to be held next month. But that the G–7 are skeptical about any large scale financial aid which some observers have suggested.

It would also be helpful to have a report on what, if any, action was agreed to by the G–7 to address the sharp rise in the dollar that has taken place, as well as whether any action may be taken to lower interest rates.

Mr. Secretary, since we have you here right after the G–7 meeting, anything you can report on that meeting, both as it affects the Fund and more broadly, would be of interest to the subcommittee.

Before I turn to Under Secretary Mulford for his testimony, I yield to the ranking Republican member of the committee, Senator Mack of Florida.

Senator Mack?

OPENING STATEMENT OF SENATOR MACK

Senator MACK. Thank you, Mr. Chairman. And welcome, Mr. Mulford.

This weekend, the finance ministers of the G–7 nations said that the Soviet Union might be offered associate membership in the IMF.

As I understand it, associate membership means that the Soviets will get advice, but no borrowing privileges. Ultimately, the question is not just about advice, but about the billions of dollars that Mikhail Gorbachev said in his speech to the Nobel Committee that the Soviet Union was "entitled" to receive from Western taxpayers.

Let us be absolutely clear about this—the Soviet Union should not receive one dime from the IMF unless key reforms are implemented. They must end their efforts to prop up the Stalinist regime in Cuba. They must end their modernization of strategic weapons and slash their defense budget. They must cease the use of force to rein in the Baltics and against democratic movements. They must submit their national leadership to free and fair elections. And they must formally dismantle the central planning system and allow private property and free markets.

These demands are certainly not unreasonable. In fact, the new President of Russia, Boris Yeltsin, agrees with all of them. These reforms are not only in our interest, but they're in the interest of the people of the Soviet Union.

We would betray them and ourselves if we settled for anything else.

And as a matter of fact, during our meeting with Boris Yeltsin last week, the question was posed to him whether aid to the Soviet Union would undermine or thwart the efforts and the forces of democracy. And his answer was yes.

Unfortunately, we have a long way to go. Less than 2 weeks ago, the Soviet Ambassador to Washington dismissed U.S. demands to end aid to Cuba. He said:

> You don't like Cuba? So what? Why should we be deprived of a right to a special relationship with any country? All these references to our help to Cuba are just hindering relations between this country and my country.

I agree with those who say that democratization of the Soviet Union could be the greatest victory for freedom and human rights in this century. But I also agree with Harvard's Richard Pipes, who says:

> For the time being, the best way to help the Soviet Union is not to help it; that is, to force its leadership to confront and boldly resolve problems accumulated over seven decades of totalitarian mismanagement.

When the IMF quota increase comes to the floor, I intend to offer an amendment laying out conditions for U.S. support for Soviet membership in the IMF.

Thank you, Mr. Chairman.

Senator SARBANES. Thank you very much, Senator Mack.

Secretary Mulford, we'd be happy to hear from you.

STATEMENT OF DAVID MULFORD, UNDER SECRETARY FOR INTERNATIONAL AFFAIRS, DEPARTMENT OF THE TREASURY, WASHINGTON, DC

Mr. MULFORD. Thank you, Mr. Chairman. It's a pleasure, as usual, to be up here this morning.

I have submitted lengthy testimony for the record and will restrict my comments to a very brief summary and then open up to questions.

Senator SARBANES. The full statement will be included in the record, but feel free to take whatever time you feel you need in order to adequately summarize the statement.

Mr. MULFORD. Thank you, Mr. Chairman.

I'm pleased to have the opportunity this morning to testify on the proposed legislation to authorize U.S. participation in the quota increase of the International Monetary Fund.

As you yourself said, Mr. Chairman, the quota increase which was agreed to in principle in May of last year, would raise the basic resources of the IMF by 50 percent from approximately $130 billion to $195 billion, and the U.S. quota in the Fund by approximately $12 billion, from $26 billion to $38 billion.

This legislation represents a key foreign economic policy initiative of the administration.

Throughout the world, centrally planned, state run models of economic development and one party governance are being rejected. In Eastern Europe, Latin America, Africa and Asia, the focus of economic reforms is on developing free markets and private enterprise.

In pursuing their paths to political and economic freedom, these countries are turning to the IMF. The United States has encouraged the Fund to take a leadership role in responding to these challenges and the Fund is doing just that.

The IMF took quick and decisive action in the Gulf crisis, responding to the increased oil import bills faced by developing countries and the costs of the U.N. sanctions on Iraq.

In Eastern Europe, the Fund is at the forefront of international efforts to assist countries in restructuring their economies away from central planning and making the transition to free markets and private enterprise.

This year alone, the Fund has already committed $8 billion to this region.

The Fund is also continuing to play a pivotal role in the U.S.-led international debt strategy, the Brady Plan. Eight countries—Chile, Mexico, the Philippines, Costa Rica, Morocco, Venezuela, Uruguay and Nigeria—have reached agreements with commercial banks on packages including debt and debt service reduction. These countries together account for nearly half of the total commercial bank debt held by the major debtors.

Fund adjustment assistance——

Senator SARBANES. Could I interject right there, Mr. Secretary?

Mr. MULFORD. Yes.

Senator SARBANES. How much of the remaining half do Brazil and Argentina, which I think are the other two big debtors, account for?

Do you know?

Mr. MULFORD. I believe, Mr. Chairman, if you were to add Argentina and Brazil, that figure would rise to something in excess of 90 percent, in terms of the volume of debt that is treated.

Senator SARBANES. So if those two countries could be added to the eight for whom the Brady Plan has already been instituted, you would have impacted 90 percent of the commercial debt?

Mr. MULFORD. That's right.

Senator SARBANES. OK. Thank you.

Mr. MULFORD. Fund adjustment assistance and support for debt and debt service reduction agreements have been particularly important in Latin America, which, of course, is one of the largest export markets of the United States.

The Fund is also an integral part of international efforts to encourage comprehensive economic reforms and provide concessional financing to the poorest countries of the world, particularly those of Sub-Saharan Africa.

If the Fund is to meet the challenges of the world economy, it must have adequate resources to fulfill its systemic responsibilities. For this purpose, the IMF regularly reviews the adequacy of its quotas. The current quota review was to be completed in 1988. However, the conclusion of these negotiations was delayed by 2 years as the United States insisted that there be a strong case for additional resources.

Thus, this is the first quota increase in 8 years.

The Fund's role in responding to global economic challenges is resulting in substantial resource demands. The Fund currently estimates disbursements this year will total $16 billion and remain high in follow-on years.

As a result, measures of Fund liquidity are expected to drop.

For these reasons, the proposed quota increase is timely. The Fund's resource base is being depleted. The quota increase is forward looking. These resources must serve the Fund over the medium-term period that lies ahead.

Support for the IMF is an extremely effective means for advancing U.S. interests. Use of the U.S. quota by the IMF involves no net budgetary outlays. This is because, as you've said, Mr. Chairman, any transfer of dollars to the Fund is immediately offset by the receipt of an equivalent interest bearing and liquid monetary reserve asset.

IMF financing also leverages our scarce resources which is critical at this time of budget constraint. For every $1 the United States contributes to the Fund, others contribute $4.

The United States is also well positioned to influence IMF policies. Our voting share in the IMF of some 19 percent gives us veto power over key IMF decisions, such as quota increases and amendments to the Fund's charter, which require an 85-percent special majority vote.

This veto power has often proven essential to ensure that the Fund operates in a manner consistent with overall U.S. interests.

IMF support for a sound and stable world economy is crucial to maintaining conditions in which U.S. jobs and exports can thrive. U.S. economic interests are increasingly tied to international economic developments.

In 1990, virtually all of U.S. economic growth was accounted for by the increase in exports. It is estimated that one in four new jobs in the United States is related to exports.

The fastest growing U.S. export markets are in the developing world. Many of our developing country trading partners have received IMF assistance in support of market opening measures and increased growth.

As I have noted, the foreign policy interests of the United States have been well served by the Fund in an effective manner. The world economy stands at an historic juncture in which U.S. interests will be deeply affected.

It is critical we support the IMF now if we are to continue our strong leadership in this central global institution, as it helps shape the world economy of the 1990's.

Thus, on behalf of the administration, I strongly urge you to support passage of the IMF quota legislation.

Thank you, Mr. Chairman.

[The complete statement of David C. Mulford follows:]

STATEMENT OF THE HONORABLE
DAVID C. MULFORD
UNDER SECRETARY OF THE TREASURY
FOR INTERNATIONAL AFFAIRS
BEFORE THE
SUBCOMMITTEE ON INTERNATIONAL FINANCE AND MONETARY POLICY
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
UNITED STATES SENATE
JUNE 25, 1991

Introduction

Mr. Chairman and Members of the Subcommittee, I am pleased to testify today on the proposed legislation to authorize U.S. participation in the quota increase of the International Monetary Fund (IMF).

The IMF quota increase, agreed to in May of last year, would raise the basic resources of the IMF by 50 percent from $130 to $195 billion, and the U.S. quota in the Fund by some $12 billion from $26 to 38 billion.

This legislation represents a key foreign economic policy initiative of the Administration. Its passage is critical if the IMF is to help shape the world economy and respond to the challenges of the 1990s.

The IMF is the cornerstone of the world economy. Established in the wake of the Great Depression and the immediate aftermath of World War II, the Fund was charged with the critical mission of promoting the smooth functioning of the international monetary system and restoring international monetary cooperation.

Throughout its history, the IMF has promoted an open and dynamic world economy -- consistent with U.S. principles and foreign economic policy interests -- that has contributed to U.S. job expansion and economic growth. It has helped support countries of vital interest to U.S. national security. The United States has been the leading force behind the Fund over the years, reflecting a strong tradition of bipartisan support for the institution during Democratic and Republican administrations.

The IMF's Role in the Current Global Economic Setting

The world economy now stands at a critical juncture. Throughout the world, centrally-planned, state-run models of economic development and one-party governance are being rejected. In Eastern Europe, Latin America, Africa, and Asia, the focus of economic reforms is on developing free markets and private enterprise. These developments point to the emergence of a new international order of multilateral cooperation and have increased prospects for enhanced international economic stability and prosperity.

In pursuing their paths to political and economic freedom, these countries across-the-board are turning to the IMF for policy guidance and adjustment assistance. They recognize that Fund programs act as an international "seal of approval" and a catalyst for other sources of financing. Both Czechoslovakia and Bulgaria, for example, began their reform efforts by applying for membership in the IMF. The United States has encouraged the Fund to take a leadership role in responding to these challenges and the Fund is doing just that.

The IMF took quick and decisive action in the Gulf crisis, responding to the increased oil import bills faced by developing countries throughout the world and the severe costs of the U.N. sanctions on Iraq. Following the lead of President Bush, who addressed the World Bank and IMF at their Annual Meetings in September 1990, the IMF implemented changes in its policies to ensure it was well-positioned to help adversely-affected countries. A key measure was the introduction of compensatory financing, on a temporary basis, to assist countries in coping with higher oil import costs. The Fund has already committed over $3 billion to countries adjusting to the disruptions brought about by Iraq's invasion of Kuwait. The IMF also provided crucial analytical support to U.S.-led efforts by the Gulf Crisis Financial Coordination Group (GCFCG) to help the front line states (Turkey, Egypt, and Jordan) during the crisis.

In Eastern Europe, the Fund is at the forefront of international efforts to assist countries in restructuring their economies away from central planning and making the transition to free markets and private enterprise. The Fund led the way in Poland and Hungary and is building a strong framework elsewhere for market-oriented adjustment. This year alone, the Fund has already committed $8 billion to the region. These monies are supporting three-year financing arrangements in Poland and Hungary and stand-by arrangements in Czechoslovakia, Bulgaria, and Romania. In addition to program financing, the Fund has disbursed substantial compensatory financing to all five countries to help address increased oil import costs arising from the Gulf crisis and the switch to hard currency trade relations with the Soviet Union.

The Fund's support has unlocked substantial additional financing for Eastern Europe. In Poland, the Fund's program has formed the basis for the recent agreement by official creditors to reduce the country's debt and debt service obligations by 50 percent. Throughout the region, Fund arrangements are a critical element in catalyzing new resources from donor governments through the G-24 process, from private capital markets and through the Paris Club.

The Fund is also continuing to play a pivotal role in the U.S.-led international debt strategy, the "Brady Plan." Eight countries -- Chile, Mexico, the Philippines, Costa Rica, Morocco, Venezuela, Uruguay, and Nigeria -- have reached agreements with commercial banks on packages including debt and debt service reduction. These countries account for nearly half of the total commercial debt held by the major debtors.

Fund adjustment assistance and support for debt and debt service reduction agreements have been particularly important in Latin America, one of the largest export markets of the United States. Sound, free-market policies and the reduction in debt and debt service obligations have dramatically improved growth prospects in many of these countries. In Mexico, for example, inflation and interest rates have dropped sharply, growth rates are up, substantial new foreign investment has flowed into the country, and flight capital is returning. A similar turn-around in economic conditions is occurring in Venezuela. Chile's economic success is confirmed by its return to private credit markets. With Fund support, Costa Rica in 1989 reduced its commercial bank debt by 62 percent. Elsewhere in Central America, Fund programs are supporting adjustment in Honduras and El Salvador.

The Fund is an integral part of international efforts to encourage comprehensive economic reforms and to provide concessional financing to the poorest countries of the world, particularly those of Sub-Saharan Africa. Over 20 African countries currently have Fund programs. Most of the Fund programs are three-year arrangements under IMF concessional facilities and involve extensive collaboration between the Fund, World Bank, and the borrowing country. These programs are addressing the widespread need in Africa for structural reforms that are essential for achieving sustained growth and alleviating poverty.

On the strength of these programs, two countries, Nigeria and Niger, have recently reached debt and debt service reduction agreements with commercial banks. Niger is the first to benefit from International Development Association (IDA) support for such agreements.

Pressures on IMF Liquidity: The Case for a Quota Increase

If the Fund is to meet the challenges of the world economy, it must have adequate resources to fulfill its systemic responsibilities. For this purpose, the IMF regularly reviews the adequacy of its quotas. The current quota review was to be completed in 1988. However, the conclusion of these negotiations was delayed by two years as the United States insisted that there be a strong case for additional resources on the basis of a careful analysis of prospective demands, available resources, and agreement on the future role of the IMF as a monetary institution. Thus, this is the first quota increase in eight years.

The Fund's role in responding to the challenges of the Gulf war and reform efforts in Latin America and Eastern Europe is resulting in substantial current and projected demands on Fund resources. Although aggregate Fund quotas presently total around $130 billion, only about one-half of these quota resources are considered usable (i.e., resources from countries which are not borrowing from the Fund and which have strong financial positions). From this pool, substantial amounts have already been lent. Thus, the Fund currently estimates that it has about $30-35 billion remaining for lending over the five-year period normally covered by the quota review.

Fund resources will be significantly depleted in the period ahead. The Fund currently estimates that disbursements this year will total $16 billion -- more than double last year's lending. Disbursements are expected to remain high in follow-on years. As a result of heavy financing demands and loans, measures of Fund liquidity are expected to drop by almost 40 percent this year and decline further next year. Furthermore, a substantial portion of the loanable resource base could be removed if a major creditor's balance of payments position were to weaken.

For these reasons, the proposed quota increase is timely. The Fund's resource base is being depleted. The quota increase is forward-looking. These resources must serve the Fund over the medium term.

Effectiveness of U.S. Support for the IMF

Support for the IMF is an extremely effective means for advancing U.S. interests.

Use of the U.S. quota by the IMF involves no net budgetary outlays. This is because any transfer of dollars to the Fund is immediately offset by the receipt of an equivalent, interest-bearing and liquid monetary reserve asset. This accounting treatment is used internationally. Over the years, the United States has drawn 24 times on its reserve position for a total

amount of $6.5 billion. It last drew on its reserve position in 1978 for some $3 billion.

Indeed, during the 1980s, U.S. participation in the IMF has resulted in a net financial gain of $628 million annually. This gain reflects interest earnings and valuation gains on our reserve position in the IMF, which sharply exceeded the borrowing costs to the Treasury associated with financing transactions with the Fund.

The budget agreement makes specific provision for the unique budgetary treatment of the IMF quota increase. The approximately $12 billion increase in the U.S. quota will not result in any net budgetary outlays. Also, this appropriation is only available for the quota increase; it could not be applied, for example, to other discretionary spending programs.

IMF financing also leverages our scarce resources, which is critical at this time of budget constraint. For every dollar the United States contributes to the Fund, other countries contribute four.

The United States is also well positioned to influence IMF policies. Our voting share in the IMF of some 19 percent gives us veto power over key IMF decisions, such as quota increases and amendments to the Fund's charter, which require an 85 percent special majority vote. In addition, our voting share positions us to build majorities on other major issues, requiring super-majorities of 70 percent for approval. This veto power has often proven essential to ensure that the Fund operated in a manner consistent with overall U.S. interests.

The Strengthened Arrears Strategy

During the quota negotiations, a number of steps were taken to ensure that IMF resources, including U.S. contributions to the quota increase, would be used more effectively.

During the 1980s, arrears to the Fund grew sharply, reaching their current level of $4.5 billion from nine countries, an amount twice the level of the Fund's reserves. Arrears undermine the financial integrity of the IMF and its ability to fulfill its systemic responsibilities. Over time, Fund efforts to address the growth in arrears bolstered Fund reserves but failed to reverse the problem and promote a normalization of relations between the Fund and arrears countries.

Thus, in order to ensure that any increased U.S. quota contributions were wisely and productively spent, a major U.S. priority in the quota negotiations was the adoption of a strengthened arrears strategy. Our basic approach emphasized the need for a comprehensive set of incentives and disincentives designed to reward sound performance and to discourage new arrears.

The plan eventually adopted by the Fund closely mirrors the U.S. approach and includes two main elements.

- First, the key to addressing current arrears cases is sound economic performance to restore creditworthiness. Thus, to create an incentive for sound performance, countries which cooperate with the Fund and demonstrate sustained performance under a 2-3 year Fund-monitored arrangement can now earn "rights" to special financing to clear their arrears.

- Second, countries that over time do not fulfill their responsibilities cannot be expected to enjoy the benefits of membership. Thus, if any country does not cooperate in clearing its arrears and continues to fail to fulfill its obligations, the strengthened arrears strategy provides for an amendment to the IMF Articles that would permit the Fund to suspend that country's voting rights and representation privileges.

The rights approach is only available for the 9 remaining arrears cases that were in arrears at the time of the quota agreement. At the successful conclusion of the program, a country would gain access to special financing to help clear its arrears. To receive the financing, however, a country must establish a follow-on program so as to ensure that sound policies continue to be pursued.

Financing for the rights program will come from two main sources:

- For lower-income arrears countries, the Enhanced Structural Adjustment Facility (ESAF) will be used primarily to finance the "rights" programs.

- The two middle-income arrears cases, Peru and Panama, will be eligible for financing from a special account financed from increased charges on IMF loans and reduced remuneration.

In both cases, "rights" financing is to come from special Fund monies separate from the Fund's regular resources. In this way, the Fund will avoid establishing undesirable precedents which could undermine its monetary character.

In this context, since financing for the "rights" program for lower income countries through use of the ESAF increases the potential risk to ESAF creditors, it was agreed that the IMF would sell, if needed, up to 3 million ounces of IMF gold to back up the ESAF's already substantial reserves. This limited amount of gold reflects the gold subscriptions of the countries with arrears.

Progress is being made under the strengthened arrears strategy. The IMF recently approved a three-year "rights" program for Zambia and is working with official creditors and donors to establish a rights program for Peru. These two countries alone account for nearly half of the total arrears owed the IMF. Also, Honduras and Guyana have eliminated their arrears, while Peru, Panama, and Zambia are meeting maturing obligations to the Fund.

Under U.S. law, U.S. consent to any sale of IMF gold for the special benefit of a single member or of a particular segment of the membership must be approved by Congress. Thus, the quota legislation also seeks Congressional approval to allow the Secretary of the Treasury to instruct the U.S. Executive Director of the IMF to vote to approve the IMF's pledge to sell this limited amount of gold.

Also under U.S. law, U.S. agreement to an amendment to the IMF Articles of Agreement requires Congressional approval. Thus, we are seeking legislation that would authorize the U.S. Governor to the Fund to accept the proposed suspension amendment to the IMF Articles. This is a tough remedial measure which encountered resistance from developing countries and was adopted only at U.S. insistence and as a precondition of the suspension amendment, the quota increase cannot go into effect. The goal of the suspension amendment is positive, however: normalization of relations and the deterrence of future arrears.

Impact of IMF Activities on Poverty and the Environment

During the past year, concerns have been raised regarding the IMF's role in environmental protection and alleviating poverty.

The Administration is committed to environmental protection. Towards that end, it has given high priority to promoting Fund actions aimed at protecting the environment, consistent with Fund's basic mandate. We have achieved some important successes:

- At U.S. initiative, the Fund is establishing a group of economists that will serve as liaison with other organizations on environmental research and advise the Fund on addressing environmental concerns. The Fund is currently seeking environmental economists from outside the Fund to work, for a transitional period, with Fund economists.

- With World Bank assistance, the Fund is incorporating measures consistent with environmental protection into Policy Framework Papers (used for concessional programs) and some stand-by and extended arrangements. These can include measures to remove government subsidies on fertilizer, energy, and pesticides.

- IMF Article IV consultations include discussion of environmental concerns.

- The IMF is working with the U.N. to develop national income accounting statistics to reflect use of natural resources.

These achievements have required much hard work on the part of the U.S. Executive Director to the IMF and senior Treasury officials. We faced considerable opposition from developing and developed countries alike in securing these gains. Many countries argue that the impact of Fund macroeconomic policies on the environment is indirect and ambiguous. They are also concerned about overburdening the Fund and detracting from its primary responsibilities as a monetary institution in promoting sustained growth. Developing countries in particular are sensitive to the appearance of the Fund intruding on national sovereignty. Moreover, there is broad recognition that the World Bank is better-suited to addressing environmental concerns in an effective and lasting manner.

The U.S. is the primary force behind increased Fund attention to environmental concerns. By virtue of our leadership position in the institution, we have been able to overcome some of the reservations of others, and we plan to build on the progress that has been made. We look forward to continuing our work with Congress and the environmental community in this important area.

Turning to poverty issues, IMF conditionality is sometimes criticized as imposing austerity on countries and hurting the poorest segments of the population. This view, however, represents a misconception of the IMF's role in the adjustment process.

Countries generally come to the Fund facing severe economic imbalances. Usually, they have lived beyond their means, consuming more than they produce, and are facing a curtailment in foreign financing flows. In these circumstances, they face the prospect of "forced" adjustment -- deep and inefficient cuts in investment, imports, and growth.

In contrast, IMF policy advice and financial support offer countries "breathing room" and the prospect for a more orderly adjustment path. Experience shows that the sound market-oriented reforms the IMF supports are essential to achieve sustained growth, reduce poverty and catalyze additional external resource flows.

There are, to be sure, inevitable costs associated with the adjustment process. The Fund is sensitive, however, to these costs.

Virtually every Fund program includes support for social safety nets, such as the maintenance of expenditures for such basic human needs as health, education, and nutrition. Fund programs also allow for targeted assistance to protect the most vulnerable groups from the effects of such necessary reforms as the removal of

subsidies for basic consumer items. Costa Rica, Ghana, Venezuela, Niger, Bangladesh, and Egypt all have Fund programs which incorporate targeted government assistance for the poor.

Furthermore, in recent years, under the debt strategy, the Fund has given increased attention to growth-oriented structural reforms. This has acted in many cases to help the poor. Fund programs increasingly emphasize comprehensive structural reforms in order to free up workers, producers, and farmers to respond to market forces -- not government regulations and bureaucrats. These measures are intended to stimulate supply responses and reduce adjustment programs' reliance on fiscal belt-tightening and monetary restraint.

Also, as noted previously, in the poorest countries of the world, substantial concessional financing is being provided. As part of ESAF programs, the Fund is devoting extensive attention to cushioning the poor from the side-effects of adjustment.

These measures have been adopted with strong U.S. support and encouragement. Moreover, countries undertaking Fund-supported adjustment reforms have themselves recognized that the incorporation of social safety nets substantially enhances popular support for the program. The United States will continue to encourage the IMF to show increased sensitivity to the effects of adjustment on poverty.

Conclusion on IMF Quota Increase

Since its establishment some 45 years ago, the IMF has played a central role in strengthening growth at home and in promoting a sound market-oriented world economy consistent with basic U.S. foreign economic policy interests.

IMF support for a sound and stable world economy is crucial to maintaining conditions in which U.S. jobs and exports can thrive. U.S. economic interests are increasingly tied to international economic developments. In 1990, virtually all of U.S. economic growth was accounted for by the increase in exports. Estimates suggest that roughly one out of every four new jobs in the United States is related to merchandise exports. The fastest growing U.S. export markets are in the developing world. Many of our developing country trading partners have received IMF assistance in support of market-opening measures and increased growth. Moreover, IMF support for an open and smoothly functioning international system of payments is essential to fostering growth in trade.

The foreign policy interests of the United States have been well-served by the Fund. The quick and effective Fund response to the Gulf crisis sent a strong message of continued international support for efforts to gain Iraq's withdrawal from Kuwait. In Eastern Europe and elsewhere, economic reforms are inextricably

linked to the movement toward democracy. In Latin America especially, the Fund is supporting sound economic policies and debt and debt service reduction under the Brady Plan. IMF support is essential if countries throughout the world are to achieve peace and prosperity on the basis of democratic and market principles.

The IMF also serves our interests in an extremely effective manner. Use of the U.S. quota in the Fund involves no budgetary outlays and leverages our scare resources. We are the largest member and most influential voice in the Fund, and our large voting power gives us veto power over certain key decisions and positions us to build majorities on other major issues. The strengthened arrears strategy will ensure that increased U.S. resources are used wisely.

The world economy stands at a historic juncture in which U.S. interests will be deeply affected. It is critical that we support the IMF now if we are to continue our strong leadership in this central global institution as it helps shape the world economy of the 1990s. Thus, on behalf of the Administration, I strongly urge you to support passage of the IMF quota legislation.

Senator SARBANES. Well, thank you very much, Mr. Secretary.

I want to spend a little time here trying to develop some of the rationale for this request, both to have it on the record and to have it to be used, if necessary, as the Senate considers this matter, particularly on the floor of the Senate.

First of all, on page 5 of your statement, right at the top, you say:

> Indeed, during the 1980's, U.S. participation in the IMF has resulted in a net financial gain of $628 million annually. This gain reflects interest earnings and valuation gains on our reserve position in the IMF which sharply exceeded the borrowing cost to the Treasury associated with financing transactions with the Fund.

Could you develop that point a little bit? Is that only a paper gain or is somehow or other a real gain that somehow we realized?

Mr. MULFORD. No, that's a real gain over the period. When the Fund draws on us, it then raises our borrowing requirement. But the Fund, of course, when it draws on us, provides us in return with a liquid reserve asset that earns interest. And the combination of interest earnings on that asset, together with valuation gains with regard to the relative value of the SDR versus the dollar, have provided us together with those gains on an annual basis.

Those gains are taken into the budget each year.

Senator MACK. Let me just, if I could, follow up on that because the term liquid has been used twice.

How liquid really is this exchange of assets? If we were to call on the IMF to liquidate this asset that we've received, is that reality?

Mr. MULFORD. It's reality that an SDR can be put back to the Fund and redeemed. And also, transferred to other members of the Fund who have a need for SDR's.

So, I would say, maybe the right way to characterize it is to say that it is liquid within the internal structure of the international monetary system. It is not liquid in the sense that you can go up to New York and market it on Wall Street to small investors.

Senator SARBANES. When they draw on us and we put money in for which they then give us an interest bearing—what do we call it?

Mr. MULFORD. Reserve asset.

Senator SARBANES. An interest bearing reserve asset.

Do we then receive that interest into the Treasury?

Mr. MULFORD. Yes.

Senator SARBANES. Or does it go into our account at the IMF?

Mr. MULFORD. No, we receive that into the Treasury.

Senator SARBANES. And that interest that we receive is greater than the interest we pay in order to borrow the money to meet the call.

Is that correct?

Mr. MULFORD. Yes, plus any change in valuation of the reserve asset which is denominated in SDR. So that may in fact give us a gain in addition to—when it's valued—in addition to the constant flow of interest.

Senator SARBANES. No, but is the interest alone that we receive more than the interest we pay in order to borrow the money to get the asset?

Mr. MULFORD. Yes.

Senator SARBANES. OK. So the valuation is over and above that. That would be even more.

Mr. MULFORD. Yes. But together, they account for the figure that's in here.

Senator SARBANES. And do we realize the valuation into the Treasury, or is that realized in our account at the IMF?

Mr. MULFORD. At the end of the year, we realize that gain or loss on the asset, record it, and take it into the budget.

Senator SARBANES. Well, now, do I understand, then, that during the 1980's, we, in effect, realized about $6 billion in the aggregate from these Fund transactions?

Mr. MULFORD. Yes, during that period, on average, $628 million a year.

Senator SARBANES. So that's $6 billion that came into the U.S. Treasury net that otherwise would not have been realized.

Is that correct?

Mr. MULFORD. Yes.

Senator SARBANES. Well, you hesitated. I'd like you to double check that. That's a fairly good argument if it's in fact the case. [Pause.]

Mr. MULFORD. The answer is yes, but——

Senator SARBANES. It's the "but" we want to find out about. [Laughter.]

Mr. MULFORD. The but is that the interest differential, which is positive, is steady. That is to say, it comes in over the period. The exchange rate valuation between the dollar and the SDR is capable of movement.

So it's possible that if the dollar is appreciating against the SDR, that valuation gain would be less or even negative against the interest spread.

But to the extent each year that there has been a recorded gain, that has been a contribution to the budget of the magnitude that you mentioned.

Senator SARBANES. Well, could you give us a short memo or paper that traces that through?

Mr. MULFORD. Sure.

Senator SARBANES. How much of the roughly $6 billion over the 10 years is because of the interest spread? Do you have any idea?

Mr. MULFORD. I can't answer that question off the top of my head, but we can break that out for you.

Senator SARBANES. OK.

[The following information was subsequently submitted for the record:]

U.S. Budgetary Treatment of Transactions with the IMF

Under budget and accounting procedures established in consultation with the Congress at the time of the 1980 increase in the U.S. IMF quota, an increase in the U.S. quota or line of credit to the IMF requires budget authorization and appropriation for the full amount of increases in the quota. Payment to the IMF of the increase in a member's quota is made partly (25 percent) in reserve assets (SDRs or foreign currencies) and partly in non-interest bearing letters of credit, which are a contingent liability.

Budget expenditures occur only as cash is actually transferred to the IMF, through the 25 percent reserve asset payment or through encashment of the quota letter of credit. Simultaneous with such transfers, however, the U.S. receives an equal offsetting receipt credited to its reserve position in the Fund -- an interest-bearing, liquid asset that may be drawn by the United States at any time. Because of these offsetting transactions, transfers to the Fund under the quota subscription do not result in net budgetary outlays. Similarly, when the Fund transfers dollars to the United States (as repayment, for example, for previous drawings by borrowing members), no net budget receipt results since the U.S. reserve position declines simultaneously by an equal amount.

U.S. transactions with the Fund do affect Treasury borrowing requirements. When U.S. dollars are transferred to the Fund, for example, the Treasury incurs additional borrowing requirements associated with meeting the call on its position. Similarly, when the Fund transfers money to the United States, the Treasury cash position is improved and its borrowing requirements reduced. The net effect of transfers to and from the Fund have varied widely over the years. In recent years, between mid-1986 and end-1990, the Fund transferred $5.6 billion to the U.S. Treasury on a net basis as countries have repaid earlier drawings.

U.S. transactions with the IMF do, however, entail gains and losses. The Treasury incurs increased costs associated with any increase in borrowing requirements, for example. However, these interest costs are offset by interest (remuneration) paid by the Fund to the Treasury on its reserve position, which increases by an amount equal to any Fund use of the U.S. quota. Remuneration is paid quarterly, generally at the SDR interest rate, which is based on a weighted average of interest rates on the 3-month paper of the five countries whose currencies make up the SDR basket (United States, Japan, Germany, United Kingdom, and France). Since mid-1986, remuneration has been adjusted as part of IMF burden sharing arrangements developed in response to the

problem of overdue obligations. An additional factor affecting whether there are gains or losses is whether there are exchange rate gains and losses on our reserve position due to changes in the dollar value of the SDR. In recent years, there have been large gains.

The attached table provides an estimate of the gains and losses to the United States from transactions with the Fund for the period May 1979 to January 1991:

- The overall net annual gain to the United States, taking into account interest and valuation gains and losses, was $628 million.

- During this period, Treasury debt outstanding attributable to transactions with the IMF averaged around $4.1 billion annually. This is not an annual increase in Treasury borrowing, but an estimate of the average total debt outstanding each year attributable to cumulative U.S. transactions with the IMF. However, as was noted above, between mid-1986 and end-1990, the Fund transferred $5.6 billion to the U.S. Treasury on a net basis as countries repaid earlier drawings. This transfer of funds improved the U.S. cash position and reduced borrowing costs.

- Overall net interest gains to the Treasury associated with all U.S. transactions with the IMF averaged $151 million annually.

- Net annual valuation gains to the United States on the U.S. reserve position in the IMF averaged $477 million annually.

Estimated Gains and Losses Associated with U.S. Transactions Under U.S. Quota and U.S. Loans to IMF

(millions of dollars)

IMF FY Ending April 30	Cumulative Net Treasury Debt (−) or Cash (+) Position Arising From: Transactions Under U.S. Quota (1)	U.S. Loans to IMF (2)	Total (3)	Borrowing Cost (−) or Reduction (+) from Column (3) (4)	Interest Received by U.S. on Loans to IMF (5)	Remuneration Received by U.S. from IMF (6)	Valuation Gains (+) or Losses (−) on U.S. Reserve Position (7)	Total Net Gains (+) or Losses (−) (8)
1980	1,418	0	1,418	189	0	0	(45)	144
1981	1,540	(462)	1,078	125	16	22	(143)	20
1982	(850)	(967)	(1,817)	(246)	88	216	(204)	(146)
1983	(3,960)	(1,568)	(5,528)	(499)	131	345	(234)	(257)
1984	(5,335)	(1,485)	(6,820)	(611)	160	504	(246)	(193)
1985	(5,292)	(1,265)	(6,557)	(597)	171	660	(725)	(491)
1986	(7,306)	(1,229)	(8,535)	(594)	132	614	2,528	2,680
1987	(6,256)	(892)	(7,148)	(399)	86	478	2,653	2,818
1988	(4,989)	(475)	(5,464)	(317)	63	424	600	770
1989	(2,267)	(171)	(2,438)	(185)	33	439	629	916
1990	(2,977)	0	(2,977)	(233)	12	529	57	365
1991^	(4,614)	(3)	(4,617)	(334)	1	393	851	911
Total Period:				(3,701)	893	4,624	5,721	7,537
Annual Average	(3,407)	(710)	(4,117)	(308)	74	385	477	628

^Through January 31, 1991

Senator MACK. So the $628 million per year is a combination of increasing the value of the asset and——

Mr. MULFORD. No, it's a combination of the interest earned and whatever valuation gain or loss was recorded during each year.

Senator SARBANES. The $628 million is the annual average over the 10-year period.

Is that correct—of the 1980's?

Mr. MULFORD. Yes.

Senator MACK. And I guess the only question that I would have is a followup to that.

Mr. MULFORD. I can give you some guidance on the question you raised.

The valuation gains or losses over that decade total $5.7 billion and the total gains or losses were $7.5 billion. So the difference between the $7.5 billion and the $5.7 billion is the interest earned, and the balance of it is the exchange rate gain.

Senator MACK. Now that interest earned, is that a net figure? In other words, after taking out the cost of borrowing.

Mr. MULFORD. Yes.

Senator MACK. OK.

Senator SARBANES. So we earned $1.8 billion over the decade on the interest spread and we earned $5.7 on the valuation.

Mr. MULFORD. Yes.

Senator SARBANES. All right. Now I'd like to go through a series of questions to assess the need of the IMF for this quota increase.

First of all, what is the current level of resources available to the IMF?

Mr. MULFORD. Well, the resources available to the IMF, and I refer here to the usable resources——

Senator SARBANES. Well, let's do the bigger figure first. The total current level is $130 billion, as I understand it.

Mr. MULFORD. $130 billion, that's right, yes.

Senator SARBANES. Now of that, only a portion of it is actually usable.

Mr. MULFORD. About $65 billion is usable.

Senator SARBANES. And why is that?

Mr. MULFORD. That's because countries contribute their currencies and for one quarter of their quota, they contribute hard, convertible currency, or the equivalent.

And a number of these currencies, because they are not fully convertible, are not therefore usable.

That definition is a highly complex definition and it results in a varying amount at all times. But generally, about half of the resources of the Fund are usable and about half are not by that definition.

Senator SARBANES. All right. So the usable figure is about $65 billion.

Is that correct?

Mr. MULFORD. Yes.

Senator SARBANES. How much does the IMF currently have outstanding and lending?

Mr. MULFORD. Well, it has approximately—it has about $30 to $35 billion of the $65 billion that are still usable.

Senator SARBANES. All right. If we take the $30 billion figure—in other words, about $35 billion of it has been lent out of the $65 billion.

Mr. MULFORD. About half is lent out and about half is usable at the moment.

Senator SARBANES. All right. Now if you take that $30 to $35 billion figure that's still available to the Fund, what is the projected demand for IMF loans in 1991 and 1992?

In other words, in the short future, how much of what's still available to the Fund in usable resources will be used up?

Mr. MULFORD. Well, we anticipate that in 1991, the demands on Fund resources will be just under $16 billion.

And we estimate in 1992 that that figure will be just under $10 billion.

The 1992 figure, of course, is a much less solid figure because it's very hard to project these things. But if you take those 2 years together, you would expect total demands of about $25 billion, and then you have to figure in the repayments to get to a net figure, and the net figure is probably in the neighborhood of $10 billion.

Senator SARBANES. All right. So that you would use up all but about $5 to $7 billion. Then you've have these repayments coming in over these 2 years, which would take that figure up to $15 to $20 billion.

Would that be correct?

Mr. MULFORD. Yes. I think you could say that we expect at the end of 1992, that the usable resources would then be in the range of $15 to $20 billion.

Senator SARBANES. Now, is that an adequate working—what do we say to someone who says, well, that still seems like a lot of money. That's usable resources, I take it. Are the payments usable resources, what you're adding on?

Mr. MULFORD. Yes.

Senator SARBANES. So what do you say to someone who says, well, at the end of 1992, they would still have $15 to $20 billion available to them? What is the urgency for this quota increase?

Mr. MULFORD. Well, I think there's really several points to be made in answering that question.

The first is that a quota increase is done for a period of at least 5 years. So you've got to have a sufficient resource base to address the whole period.

Guessing, or guesstimating, beyond 2 years what the resource demand is going to be on the Fund is an extremely difficult task. Who could have predicted the Gulf War, for example, or the sudden emergence of Eastern Europe, 5 years before they happened? And these have very substantial implications on the demands made on the Fund for resources.

So there's a high degree of uncertainty here.

The working liquidity of the Fund that, generally speaking, over the years, we haven't liked to go below, is around $15 billion, for just that reason—that you cannot be sure whether some very substantial demand in the world economy might come forward that would require a heavy, sudden use of resources.

Senator SARBANES. You mean an economic crisis of some sort, potentially.

Mr. MULFORD. Not just an economic crisis of global proportions, but, for example, take the Gulf crisis, which caused a sudden demand by countries on Fund resources for compensatory financing, contingency financing. We opened those access arrangements a little wider and there's been heavy use made.

Eastern Europe just this year is receiving commitments of something like $8 billion, which has developed in a very short period of time.

And we have to bear in mind that a new quota infusion is a process that takes in the neighborhood, on average, of 18–24 months of negotiation. So you've got to have enough resources to get you through the period to address a new quota increase, get it through the various legislatures around the world, and the funds actually in the IMF. And that's a process that's tended to take 18–24 months over the history of quota increases.

Senator SARBANES. Well, my time has expired, but I'd just ask two questions because I want to complete the line of questioning on this subject.

The 5-year period before you undertake another quota increase would begin to run, when? At the end of this year when this quota increase goes into effect? Or does it relate back to when the previous quota review was undertaken?

Mr. MULFORD. The articles require that a quota review be made every 5 years. And therefore, the next quota review has to be made by the end of 1993. But that does not mean that a quota increase will have to have been agreed. It simply means that the process of a review will have to have been gone through by that time.

So it dates back to 5 years before that date, 1988. As you know, we've taken 2 years longer than the 1988 date that was specified by the articles for the end of the quota review for the period, 1983–88.

Senator SARBANES. How was the decision to request a 50-percent quota increase arrived at?

Mr. MULFORD. That is arrived at through negotiation, Mr. Chairman, and that is one of the more substantial parts of the negotiation.

In this case, there were a number of countries who favored a 100-percent increase in quotas, a doubling. There was a great majority of countries that, together with the management of the Fund, favored a quota increase of 67 percent. And after a substantial negotiation, the quota increase was determined at 50 percent, and consensus developed around that figure.

But that took about 18 months or 2 years to negotiate.

Senator SARBANES. And to give us some historical perspective, how large was the previous quota increase and perhaps the one before that, if you recall?

Mr. MULFORD. I think the one before that was 47 percent, if I'm not mistaken.

Senator SARBANES. The one in 1983?

Mr. MULFORD. Yes.

Senator SARBANES. And how about the one before that? Do you recall?

Mr. MULFORD. I'd have to check that. We'd have to let you know that, Mr. Chairman.

[NOTE.—The 1978 quota increase was 50 percent.]

Senator SARBANES. OK. I'll yield to Senator Mack.

Senator MACK. Thank you, Mr. Chairman.

Let me just go back and go over some of those numbers again. The $130 billion is the total resources, of which roughly half are really usable resources.

I assume what that is, in essence, that's the basket of currencies that are generally accepted in international trade.

Is that right?

Mr. MULFORD. Yes, that's right.

Senator MACK. Help me through this, then. The U.S. portion or the U.S. quotas, 19.4 percent, is that based on usable currencies or is that based on the total $130 billion?

What I'm trying to get at is it sounds from walking through this now that the U.S. participation in this is a lot larger than 19.4 or 19.6 percent.

Mr. MULFORD. It's not a lot larger, but it is somewhat larger because our currency is totally usable.

So I guess another way to put it might be to say that although we have 19.4 percent of the quota, we account for more like 25 percent of the usable resources.

Senator MACK. Is that on average over the last—say, in the 1980's, or is that the growing——

Mr. MULFORD. I would guess that that's about average. It probably hasn't varied a great deal. Maybe it's come down as more—over the full life of the Fund, I would guess it's probably come down as more and more usable currencies have established themselves.

But in recent times, I don't think it's changed.

Senator MACK. What effect, and maybe we can get into this in greater detail a little bit later on, but the question of the arrearages.

Mr. MULFORD. $4.6 billion.

Senator MACK. $4.6 billion I think estimated at this point.

Do you have a sense as to whether that's going to be a figure that's going to continue to grow?

Senator SARBANES. Mr. Secretary, you have that in your statement, but you didn't do it in your presentation. I think it might serve a purpose if you took a couple of minutes to develop a full response to Senator Mack's question on the arrearages because that's obviously an issue that may come up.

Senator MACK. I think also it would be helpful to address the issue of is this a new phenomenon for the IMF, to have this amount, $4.6 billion or so, in arrears? Is this a new thing or is this something that the Fund has dealt with off and on since 1945?

Mr. MULFORD. Well, let me try to give you a thumbnail sketch.

The arrears at present are from nine countries. Some months ago they were from 11 countries. So two countries have solved their arrears problem.

Senator MACK. Again, let me just ask the other question.

They've solved the problem, I guess, by coming to an agreement with the IMF as to what they're going to do with their internal economic policies, which the IMF then believes will allow this country to, over a period of time, eliminate the arrearages.

Is that correct?

Mr. MULFORD. No. Two countries actually paid off their arrears. So I will address now the arrearage problem as it stands today, which is, as you've said, $4.6 billion, accounted for by nine countries.

Senator SARBANES. Who were the two that paid it off?

Mr. MULFORD. Honduras and Guyana. They were quite small numbers. And in this group of nine countries, some of the numbers are quite small, but four or five of the countries have very large arrears.

Those countries are Zambia, Sudan, and Peru. They are the largest arrearage countries. The other countries—Kampuchea, Liberia, Panama, Vietnam, Somalia, Sierra Leone, are smaller.

Together they make up $4.6 billion.

The arrears that have grown in the Fund are of great concern to us. That was not a phenomenon previously associated with the Fund. It is something that has developed during the course of the 1980's, during this international debt crisis that we have been going through. And we became so concerned about it that we insisted as a part of this present quota negotiation that there had to be some sort of program developed to address the arrears problem because, in our opinion, they were threatening to the long-term health of the Fund.

And that is why the quota increase legislation has been done in such a way as to link the resolution of the arrears problem to the implementation of the quota increase.

There are three main elements in the U.S. proposal for the resolution of the arrears problem. The first is to create an incentive to clear the arrears by setting up a program where countries that are in arrears, but who wish to reform their economies and work their way out of arrears can create a program with the Fund under which they accumulate rights over a period of years. And if successful in implementing the program, those rights can be encashed for money that is immediately used to remove the arrears.

However, the resources for that do not come out of the main body of Fund resources. They come out of a special body of money that has been developed for poor countries in the Fund, the ESAF. This facility of special resources is going to be used for this purpose.

So that a country——

Senator MACK. Where do those resources come from?

Mr. MULFORD. Those resources have been pledged by specific countries at various times for the purpose of making a sort of window of resources for the poorer countries in the Fund.

Senator MACK. And this is over and above contributions on quotas.

Mr. MULFORD. Over and above the country quotas, that's right.

So the main body of resources of the Fund, the quota resources of the Fund is not available to solve the arrears problem.

However, when a country has performed and has earned the rights and has removed its arrears, it then reopens its access, which now is closed, to the regular resource base of the fund.

Senator MACK. So they would have two sources, then, at the conclusion of taking care of the arrearage. They'd be able to go back

into the normal funds of the IMF and they would also be able to draw as a result of these rights that they've earned?

Mr. MULFORD. No, they would draw for the rights on, let's say, the ESAF resources and that money would be immediately used to eliminate the arrears.

That would then put the country back in good standing and it could once again enjoy its full rights.

A country that does not take advantage of this program and which is in arrears or which makes the attempt and fails and refuses to complete the program, ultimately will lose rights that it has in the Fund—rights of representation, rights to vote. And ultimately, if it does not cooperate, it would be dismissed from the Fund.

Senator SARBANES. Now that requires an amendment to the articles, did it, that sanction?

Mr. MULFORD. Yes, that requires an amendment to the articles and getting that amendment was made a condition for implementing the quota increase in the quota negotiation.

So there will be no quota implementation if, for some reason, that arrears program and the necessary change to the articles is not agreed.

Senator MACK. And that amendment has not been agreed to at this point.

Is that right?

Mr. MULFORD. It has been agreed to in the quota negotiation and will be implemented when the quota increase takes place, because they're linked together.

Senator MACK. You have no concern about getting the necessary votes?

Mr. MULFORD. My only concern is getting the legislation through the U.S. Congress.

Senator SARBANES. If they don't change the articles, there's no quota increase.

Is that right?

Mr. MULFORD. That's right.

Senator MACK. You mentioned three things with respect to the arrearages.

Did you get all three of them?

Mr. MULFORD. The second is the amendment to the IMF articles necessary to provide for the suspension of voting rights and other privileges which for countries that don't meet their IMF obligations. That's the second point.

The third point is a preventative measure to toughen up the approach in the Fund to the scrutiny of protracted users of IMF resources.

In other words, a country that has used the resources again and again and doesn't really complete its reform always may have the temptation to say, well, this is such a hard course, that we should just let arrears build with the Fund.

Now, a country which is not now in arrears, therefore, not one of these nine, that in the future allows arrears to build, will immediately face the toughened up article that will allow their rights to be suspended and over time, result in their being evicted, in a

sense, from the Fund if they allow arrears to develop and then make no effort to cure them.

But a new country going into arrears does not get the benefit of the present program; that is only available to countries in arrears that are now trying to cure them.

In other words, there is no incentive on the part of a country to decide to go into arrears in order to get into this program and earn some special favors.

That is not a possibility.

Senator MACK. Let me just follow up with one additional question with respect to, in the discussions to determine the amount of resources that you were going to need for the next 5 years, what weight or what dollar amount did you come up with with respect to what you think future arrearages might be?

In other words, what kind of projections did you make with respect to this problem? Is it going to get better? Is it going to get worse?

Mr. MULFORD. In coming up with a quota strategy, we made the calculations about the size of the quota increase strictly on the basis of our view of what we thought the world demand for resources from the Fund over the period in the future might be.

We did not take into account arrearages because arrearages are unacceptable to us. They're already too high and our view was they need to be resolved and reduced.

So this program is aimed at accomplishing that.

Senator MACK. I can appreciate the perspective or the sense that these arrearages are unacceptable, and I assume that when people looked at the 1983 quota increase, they also felt the same way.

But, in essence, I guess $4.6 billion of usable resources are now taken out of the flow of funds and no longer can be used until these problems are worked out. So it does have an impact on the usable resources of the IMF.

Mr. MULFORD. It reduces the flows coming back to the Fund, that's right. But I think in 1983, if I'm not mistaken, there were no arrears. Arrears have grown only in the period since 1983.

Senator MACK. I understand that. My point is that I'm sure in 1983, that there was no analysis that would have concluded that a portion of the increased quota should be for the purpose of covering arrearages.

But they have occurred and they could occur again, and that's the reason why I was pursuing that point.

Thank you, Mr. Chairman.

Senator SARBANES. Well, I guess the question is, while we know you don't want arrearages, how realistic is your assumption that there will be no further arrearages?

Mr. MULFORD. Well, I think that it's a fairly realistic assumption in the sense that a country that allows arrears to grow with the IMF is making a decision that puts it entirely beyond any sort of access to resources around the world from the private sector or, indeed, from the public sector because not to be a member in good standing with the IMF is a very serious matter. And if you're not in good standing, your chances of obtaining financial resources from other countries or institutions is extremely small. Especially

over time. If you continue to build these arrears, you become a pariah outside the system.

And that is why the building of a program to give a chance to countries to work their way out of arrears is so very important, because otherwise, it's an absolutely hopeless situation. And ultimately, those countries could build arrearages equivalent to the Fund's entire exposure to them.

In some cases, that's not very large. In other cases, it is larger.

In the case of Peru, for example, they have, since the new Government came into power, begun to fully pay all of their current commitments to the IMF. But they have this body of arrears outstanding from the previous Government and they have developed and are developing a program to gradually work their way out of those.

But meanwhile, they are now paying again.

Other countries are in the situation where they have not paid past arrears and arrears are still gradually building because they're unable to make those payments.

Senator SARBANES. Senator Graham?

Senator GRAHAM. Last week, the United States signed a framework agreement with Brazil, Paraguay, Uruguay and Argentina as a precursor to a free trade agreement negotiation after the United States-Canada-Mexico negotiations have been completed.

What will be the role of the IMF in that framework agreement with the four countries in South America?

Mr. MULFORD. The IMF does not have a direct role in that framework agreement. That's just between those countries and the United States.

Senator GRAHAM. Do you see the IMF as having a role downstream in terms of implementing the goals of an expanded free trade agreement?

Mr. MULFORD. Not specifically, but the IMF does have programs that support economic reform in a number of the countries concerned—Argentina, Uruguay, and hopefully soon, in Brazil.

So they are contributing to the economic reform of those countries, the opening of those markets and so on. But they are not specifically participating in the trade field, as it is defined in that agreement.

Senator GRAHAM. Well, didn't the Enterprise for the Americas have dimensions beyond trade?

Mr. MULFORD. Yes.

Senator GRAHAM. Particularly in terms of internal reform and debt issues, and on debt especially for those countries whose principal debt was not commercial, but rather international, bilateral.

Mr. MULFORD. That's right. In the Enterprise initiative, there is a program where countries that have agreed to open their investment regimes, we are prepared to enter into negotiations to reduce U.S. official bilateral debt. And the conditions for them to engage in that negotiation with us are that they have an IMF program in place, they have access to the World Bank, and that they have an investment sector loan from the Inter-American Development Bank which results in the opening of their investment regime.

When those conditions are met, we're prepared to negotiate a reduction in concessional U.S. bilateral debt.

Senator GRAHAM. Could you elaborate on the role of the IMF today in Latin America, maybe using as a specific example, Argentina, a country in which there has been involvement and Brazil, one in which there is hoped to be involvement?

Mr. MULFORD. Yes. The IMF has played an extensive role throughout Latin America in the past 10 years by having economic reform programs in place with a number of countries, a large number of countries.

At the moment, there is not a program in place with Brazil. There has been a program in place with Argentina. It's being renewed at the moment. It has been negotiated and is about to be put back into place.

In the case of Mexico, there was a 3-year extended fund arrangement agreed in 1989 for $4.3 billion, and that has been an enormous success story. On the basis of that agreement, the debt reduction deal was negotiated with the banks and Mexico's economic situation has turned around dramatically.

There has been an IMF program in place since 1989 with Venezuela. An IMF program was used during the period, 1985 through 1989 in Chile, which has now returned to private markets. And there are a number of other cases of successful IMF programs—Costa Rica, Bolivia, et cetera.

So with practically all the countries in the region that are undertaking credible reform, you will find an IMF program is a key feature of that entire process.

Senator GRAHAM. What do you contemplate would be the nature of the IMF agreement with Brazil?

Mr. MULFORD. Well, the Brazilian President was just here and he explained to President Bush that he is now engaging in the process of negotiation with the IMF to establish an IMF standby program which will probably be a 1- or 1½-year program. And then when that is negotiated, Brazil will begin immediately to negotiate an extended fund facility, which is a 3-year program. And in the context of that medium-term program, Brazil will address with the commercial banks the medium-term package that needs to be worked out for Brazil to fully utilize the so-called Brady Plan.

That process is beginning. IMF people were in Brazil recently. They'll be going back there soon and the negotiations will take place over the next few months.

Senator GRAHAM. What proportion of the additional funds that the quota increase will allow do you see being targeted at Latin America?

Mr. MULFORD. Well, it's not so much targeting as it is anticipating where the demands might come from. Just to give you an idea, in 1991, we anticipate that of the nearly $16 billion use of resources, about $5.1 billion will be in the Western Hemisphere, and that of course is mainly Latin America, the Caribbean, Central America.

In 1992, of a total of about $10 billion, we expect about half again, about $5 billion, will be used in the Western Hemisphere.

The 1992 figure, though, does not, I believe, include an assumption for Brazil. If Brazil were to become a user of the resources in 1992, that figure would probably be higher.

Senator GRAHAM. Thank you, Mr. Chairman.

Senator SARBANES. Secretary Mulford, a number of people have raised questions about the impact of the activities of the International Monetary Fund on environmental issues and the question of environmental protection.

It's my perception that through your leadership in the Fund, the United States has taken a forward position on the environmental questions.

But could you give us some sense of the Fund's response—well, first of all, some sense of the nature of the dialog within the Fund on the environmental issue. Second, the degree of the Fund's response. And third, what more needs to be done and might be done in that area.

Mr. MULFORD. This is, first of all, an extremely complex and politically delicate problem because of the differing views on the question of the appropriateness of a role in environmental matters by an international institution.

So the background on this is charged with differences of opinion.

One of the bases for the differences of opinion is that the IMF is not a development institution like the World Bank or the IDB. It is a monetary institution that is concerned with balance of payments, stabilization programs which, by definition, are relatively short term in duration and have to do with the stabilization of the entire economy.

So there has been a view that it is not appropriate to have a strong environmental presence within the Fund, whereas, it may well be within the World Bank or the IDB.

This is not a view that we've shared but this is the background to the problem.

We have worked in recent years to increase the sensitivity to environmental issues in the Fund and in Fund programs. And we have succeeded recently in establishing within the Fund a special group of economists that will serve as a liaison with other institutions and organizations on environmental research and advise the Fund on addressing environmental concerns within its overall programming arrangements for IMF standby programs.

So now the Fund is beginning to incorporate in its programs in collaboration, for example, with the World Bank, measures that are consistent with environmental protection. These have been incorporated into policy framework papers which are used for concessional loans to lower income countries and in some of the standby arrangements and extended arrangements negotiated with other countries.

The IMF's annual consultations with countries, which are called the article IV consultations, are carried out with every single member of the Fund, usually each year. This is a review of that country's own domestic policies, even though it may not have a standby program. The United States does this each year, for example, with the Fund.

That process is including now some discussion of environmental concerns.

So the level of concern, the level of attention, is being increased within the Fund. And I think this is a sign of considerable progress.

Senator MACK. Let me just raise a question that came to my mind. You were saying that there are those who say that the IMF is not the appropriate place for this kind of activity because it is primarily a monetary effort to take care of balance of payments problems.

Is the IMF still an institution that's primarily interested in the balance of payments problems or has it in fact become a development institution?

Senator SARBANES. That's a good question. My perception is that the IMF has moved in that direction in recent years.

Mr. MULFORD. I think that is a good question and I think the answer to it, at least as far as we're concerned, is that the IMF is still a monetary institution. It is the cornerstone monetary institution for the International Monetary System.

Its chief function remains the financing temporary imbalances in the global economy. These have always been tied up with economic policies and economic policy reform, even when those transactions were mainly with the large industrial countries who were having balance of payments troubles.

So that the type of concentration of the Fund is still the same. However, what is different is that the customers or clients that are using the resources, who are having these problems and with whom the Fund is negotiating economic reform programs, are heavily dominated now by the developing countries.

And they clearly have developmental problems. And the Fund is forced to address economic policy reform on a broader and more fundamental basis, and the process of change is more difficult.

So there is the appearance of a shift toward development activities. But I don't think it's fair to say that the Fund has become a developmental institution in the sense that the World Bank or the IDB or other similar institutions are development institutions.

Senator SARBANES. What about the criticism of the IMF for imposing austerity programs on much lesser developed countries and thereby precipitating a political crisis of stability in those countries?

And the criticism that's made is that the Fund, in effect, places the greatest burden on those segments in those societies least able to bear it.

Mr. MULFORD. Well, again, I think that it's a complex issue. But I think that a balanced appraisal of that issue would go something like this.

The process of economic adjustment is never easy. Countries that come to the Fund to use the resources are already having extremely difficult economic problems. If those economic problems were not addressed, they would decline into a worse and worse economic situation and of course, as that happens, that would impact very, very heavily on the less economically well off segments of their population.

So whether or not the Fund is involved in that kind of situation, you have a very heavy risk of the sort of developments that you've mentioned.

A country that comes to the Fund has to undertake some difficult economic steps and this will, of course, cause problems. But it is done on the basis that a sensible set of policies is being put into

place that will restore stability and the basis for growth. And that is really the only way to restart the economy and therefore, to improve the prospects of all the people in that country.

So, I would have to say that a balanced view would suggest that this is a very difficult problem, but the Fund is not the perpetrator of austerity inimical to the interests of those lower income groups.

Indeed, I would say that the Fund's activities over a period of time are going to do more to cure that problem than just about anything else.

Senator SARBANES. Do you think there's a need to try to put something into the institutional arrangement of the Fund that will provide a greater assurance that environmental considerations will be given proper attention, and also, this issue that I've just raised with you in terms of not impacting on those least able to bear the impact?

Some have suggested, I understand, that there be a special unit within the Fund for environmental matters, a special unit for social or poverty questions that, in effect, would provide this perspective on all of the Fund's decisions.

Do you have any reaction to that proposal?

Mr. MULFORD. Well, I think that there already is a small unit, as I mentioned, on the environmental side which has just been created which is working within the Fund and with other institutions to bring an environmental sensitivity into the programming function.

So that's already happening in the environment.

In the case of support for poverty, there's been a clear tendency in the Fund to increase its support for social safety nets, for example, within its programs as an appropriate part of adjustment programs.

In other words, they aren't just dishing out unmitigated austerity. There has been a movement in recent years to say—these programs are difficult; we've got to make sure that we've built in here social nets that protect people. And of course, there are the SAF and the ESAF facilities, which is the money I referred to earlier for lower income countries, provided resources on a lower conditionality basis to them and on highly concessional terms, instead of basically market terms.

These concessional funds involve programs that devote very substantial attention to reducing the impact of adjustment on the poor.

So I think these things are really already in place in the Fund. We made a lot of progress there and it's a question of just keeping those movements alive and making further improvements as we go along.

Senator SARBANES. Senator Mack.

Senator MACK. Thank you, Mr. Chairman.

I want to return to the question about the Soviet access or the role of the Soviet Union with respect to special associate.

There are those who are raising the issue now that, A, they're questioning whether there really is a need for the amount of quota increase that's being discussed, No. 1, and No. 2, then tying into that that it appears that this is being done at this time to really

make the Fund have available resources large enough so that the Soviet Union can become a full member of the IMF.

As you already know from our previous discussions, David, and from my comments this morning, this is something that I feel very strongly about, that that should not occur until there is some rather significant changes taking place.

I'd be interested in your reaction to that comment or that question and to give us a sense of where the administration stands at this point with respect to the Soviet role in the IMF.

Mr. MULFORD. Well, let me give you just a bit of background on that.

First of all, we are not using or proposing the concept or the words, associate membership, because that involves membership, and we do not believe that membership of the Soviet Union in the IMF is appropriate at this time.

So the words that we're using are special associate status, a form of association which is not membership, which would allow the Soviet Union to participate in the Fund and give them certain benefits, but would not give them the full rights and duties of membership in the Fund, including the ability to draw Fund resources. They would not have that.

The President in December proposed special associate status for the IMF, and that is an idea which, in terms of its substance, has drawn a wide body of support, including at the G–7 finance ministers meeting this past weekend in London.

The reason that special associate status is, I think, the right response and is a valuable response for the Soviet Union is that it would allow the Soviets to attend functions, seminars, training programs—in other words, they would have access to the atmosphere, to the expertise and the experts within the Fund.

Second, they would be allowed to have an article IV type of liaison with the Fund, which is what I described earlier. Every country reviews its economic policies on an annual basis. And in the past, without a country being a member, the Fund has had article IV reviews with countries.

So this would be a substantive activity where all the experts in the Fund that are available and the thousands of man-hours necessary to this sort of thing could be undertaken on an intensive basis with the Soviet Union.

This would be a real contribution to their efforts to reform. They might be able to develop what's called a shadow program. That is an IMF-type program, but not with resources from the Fund. They might be willing to agree to work with the Fund to develop, instead of just a review of their economy, an actual reform program, where the Soviets would say, well, we'll negotiate this with you and then we'll abide by it and we'll try to meet these various targets, because the key issue in the Soviet Union is not just economic reform on its own. It's the concept of economic reform and, more importantly, the implementation of reform.

And a shadow program would allow that sort of process to begin. So we think this could be very valuable to the Soviets.

On the other hand, membership, which we don't think is the right way to go, would involve probably a 2-year negotiation, that is very painful, including changes of quotas, and a definition of the

size of the Soviet economy, which would be extremely difficult to do. The Soviets don't provide the kind of information that is required by the Fund today about themselves.

So there isn't a basis there for membership. But we do think there's a basis for a constructive relationship that would produce some valuable contribution to Soviet economic reform.

Senator MACK. So what you're saying is that this is not step one of a series of steps that the administration is putting into place, into action, that would allow the Soviet Union to become a member of the IMF.

And let me just go on to make my points.

It seems to me that the critical issue is that the Soviets do not become or do not have membership until in fact they have changed their economic policies and in fact reform has taken place in the sense—and I would say one of the key things is ownership of property, privatization of state-owned properties, the ability of the Soviet citizen to own and transfer property.

To me, that seems to be at the point at which I think we can all kind of sit back and say, they can't go back the other way.

Until that point, then I think there's a real question.

So it would be helpful for me to hear from you what the administration's perspective is as to what they would want to see happen before they would be talking about full membership for the Soviet Union in the IMF.

Mr. MULFORD. Well, I hesitate to say exactly what the list might be composed of, what we would have to see, because we're not at the point where I think it makes sense to make up such a list of conditions.

Senator MACK. Can you give me in a general sense?

Mr. MULFORD. I think you're right when you say that before they could move to apply to full membership, they would have to be the kind of economy which can join the IMF and become a fully participating member. And those are market-based economies that have private sectors, that have elements of freedom in the economy. There are characteristics that I think are very clear.

So our position is that the Soviets need to begin the process of economic reform at home. It could be helpful for them to have access to the Fund for the purpose of carrying out their own domestic economic policy reform.

And membership would only be something that should be considered after the Soviet Union has made some very considerable progress in that direction. There is nothing automatic or transitional about the proposal of special associate status that we have made. It isn't something that we would propose they do for 6 months and then move on. It's something that is a status unto itself which for the moment would offer a substantial advantage and then we would have to evaluate what was happening before moving further.

Senator MACK. The reason that I had some concern about that, there was an interview with a member of the IMF secretary's department and the question was asked, does a country have to adopt a market economy to qualify for membership? And the answer was no, the variety of members is testament to the fact that membership does not depend on economic and political systems.

In fact, around two dozen had or still have either centrally planned or mixed economies.

And all I'm trying to do is make sure we're not getting ourselves into a situation where one step automatically leads to the next step and the next thing we know, the Soviet Union is a member of the IMF.

Thank you.

Senator SARBANES. Senator Graham.

Senator GRAHAM. I'd like to pursue that line of questioning.

There was a news story today that the ruling party in Vietnam is having its 5-year conference and part of that conference is a reassertion of its commitment to socialist ideals.

I note that Vietnam is one of the members of the IMF and is one of the countries in arrearage.

How do we square the membership of countries like Vietnam, which have clearly a nonmarket economy, with the position that the Soviet Union will not be allowed membership until such time as it has adopted a market economy?

Mr. MULFORD. Well, first of all, I don't think I said that the Soviets could only join if they had a market economy. I hope I didn't convey that impression. I was trying to avoid making a specific list of the exact conditions because I think that that is not the way to manage that issue. Vietnam has been a member of the Fund for many years.

They became during that period a centrally planned economy. Their present attempt to move out of arrears is not something that we have yet supported. That is to say, the formation of a donor group to finance for the time being their effort to move out of arrears is something that the United States has not yet agreed to participate in for a whole variety of other related political reasons. So that's a very complex issue.

There is a group of countries led by France who favor putting together a donor's group to start the process on Vietnam much in the way that we're already trying to do with Peru and as is already underway with Zambia, for example.

But we have not agreed to support that yet.

Senator GRAHAM. If you could clarify, then, what would be the preconditions before the Soviet Union would be eligible for consideration for membership.

Mr. MULFORD. Well, I can't really say what the preconditions would be because I think that what is obvious at the moment is that it would not be appropriate for them to join as a full member at this time, nor do we believe is it in their interest to seek that membership now.

As I said before, this would be an extremely complex negotiation because all of the other countries' quotas will have to be changed. We've just been through a 2-year process of negotiating a quota increase where countries have had to accept a realignment of their quotas. Japan and Germany moved into a tied position for No. 2. France and Britain moved their positions—and this was an incredibly complex process.

If you introduce the Soviet Union, you've got to first of all define precisely the size of their economy. That can't be done today in any

credible way for a variety of reasons. We don't know enough about it to be able to pin it down.

So that's the first problem.

And the Soviets would have to subject themselves to that kind of appraisal and definition in order for a quota to be set. To reach that, the Soviets would have to open up their economic data to the IMF in a way that up till now they've not been willing to do. They did not provide—when the study was done last year by the IMF and others, data on their gold holdings, data on their budget that was adequate and that would allow a full appraisal to be made.

So that would be a long negotiation.

Meanwhile, countries like Korea and Spain, who also want to change their quotas, would take advantage of that situation to launch their own negotiations. And all the while that this was going on, there would be no prospect of resources for the Soviet Union. There would just be a long and extremely complex and heated negotiation.

We think the time in the nearterm is better spent by moving to an informal status that allows the full concentration of the IMF on the policy reform process in the Soviet Union. And even though there are no resources involved, that's probably the most important thing that can be done right now, because nobody that I know has a really good grasp of exactly what economic policy reform actually means in the Soviet Union, how it's going to be implemented, what the relationship between the center and the republics is in this process, and how any accountability for reform and performance can be established.

And those are things that need to be addressed in a realistic way, and they don't involve membership in the Fund.

Senator MACK. During this time in which they have this special status, will transparency, in essence, take place? Will there be information provided by the Soviets as to their gold reserves and budget information that you find difficult to get now?

Mr. MULFORD. I think that what will have to happen in an article IV process is a discussion of all these issues, what is going to be provided, the kinds of data.

If the Soviets believe that they are prepared to provide the same kind of data that other countries provide, then you might be able to move on to what I referred to as a shadow program and actually begin to construct with them some sort of economic stabilization program that would be broader, more comprehensive, more credible, than the kinds of things that are floating around presently in these various plans.

Senator SARBANES. Mr. Secretary, what do you say to a Member of Congress who says, well, I just don't want to approve this thing?

What would the consequences be if it's not approved?

Mr. MULFORD. There would be under this circumstance no quota increase because of the link that's been created to the arrears program and the necessity to provide the gold pledge to back up the arrears program.

Senator SARBANES. Would you expect if this wasn't approved, that there would be further negotiations at the IMF and that you might not come out as well as you did in the current negotiation?

Mr. MULFORD. Well, first of all, I think that for the United States, being the leading country in the IMF, not to follow through on a quota increase would be a matter of grave concern and would cause us probably irreversible damage as a leader in that institution.

Therefore, I'd have to conclude that the next deal we negotiate couldn't be as good as this one. We would lack the implementational credibility.

Senator SARBANES. Was this a good deal?

Mr. MULFORD. Yes.

Senator SARBANES. Why? Why don't you put that on the record. Suppose someone says, I don't think you did such a good job. What would you say to someone who said that?

Mr. MULFORD. I would say that we managed to keep the quota increase at a level that is realistic in terms of future global and IMF requirements, 50 percent.

Second, we successfully——

Senator SARBANES. You were the low person on that, or at least among the low persons.

Is that right? Is that what the quota increase should be?

Mr. MULFORD. We were just about at the bottom end of that range.

Senator SARBANES. OK.

Mr. MULFORD. And we were in a very small minority when we began. There was a large group, including, in the very first phases, management itself, the leadership of the Fund, that wanted 100 percent. They then moved down and stuck around 67 percent or 70 percent. And ultimately, the whole group came down to a 50-percent quota increase.

Second, we negotiated in such a way that we have maintained our level. We've only gone from 19.6 percent to 19.4 percent in terms of our quota share, which retains the substantial influence of the United States in the Fund.

Third, we mediated between the various other countries that were seeking to realign their quotas. Japan moved from No. 5 to No. 2, tied with Germany, and Britain declined to position No. 4, tied with France. That was an extremely complicated negotiation. We were "the honest broker" at various points in that negotiation.

Finally, we conceived what I believe is a rather creative approach to solving the arrears problem. We conceived it. We sold it. And then we negotiated it into the deal in a way that we knew we'd get it. So that when we came to see you for your approval, we wouldn't have to say, well, maybe we can get it or maybe we won't.

We've got it if we get the legislation. It can't be done without it.

So I think that's a pretty formidable result.

Senator SARBANES. Senator Mack?

Senator MACK. I want to pursue the issue of development again for just a moment.

As I understand it, when the IMF began, I think 1945, it was for the purpose to prevent serious trade and investment imbalances. And again, and it's maybe because at this point, really a lack of understanding, but it just does seem like the Fund has headed off in this direction of development.

In some of the materials that I looked over, there were 31 standby and extended arrangement programs in effect during the Fund's 1990 fiscal year, none of them involving industrial countries.

And I also tie that back with some additional information I was looking at—when, despite these efforts, a member country experiences serious but temporary imbalances, the IMF is involved.

I'm trying to get a feel for what temporary means. How long a period of time are these arrangements with those 31 standbys and extended arrangement programs?

Give me a sense of—certainly, there must be something physically, tangibly different between the activities of the IMF in the 1950's and the 1960's and the IMF in the 1980's and 1990's.

Mr. MULFORD. Well, let me come back to that issue.

First of all, with regard to the industrial countries, I don't want you to get the idea the Fund doesn't do anything with the industrial countries. There is an article IV with every country every year. There is G–7 surveillance within all the G–7 economies. When we have a G–7 meeting and as we run the G–7 economic policy coordination process, the Fund participates as the provider, keeper, collector and assessor of data from all of these economies to help us in our work to coordinate economic policy.

So the Fund plays an absolutely key role with the industrial countries today, even though it is not for the time being making balance of payments loans.

And the reason it is not making balance of payments loans to the industrial countries in recent years is that financial markets around the world have become so large and efficient that countries have turned to finance their balance of payments requirements in the markets instead of coming to the Fund, as they used to do in the 1960's and 1970's.

That is the change there that's happened.

On the other side, with the developing countries, as I said before, the business is the same. That is to say, it is a question of financing balance of payments imbalances and addressing economic policy reform issues in doing so.

The problem is that these countries' problems are much more protracted. Removing those imbalances has proved to be a much more difficult exercise.

The reason it is important——

Senator MACK. When you say much more difficult, I assume much more lengthy.

Mr. MULFORD. Lengthy. There's been countries that have had five or six programs and still haven't managed to resolve their problems.

So that is different.

Senator MACK. And five or six programs, is that 5 or 6 years or is that 10, 12, 15 years?

Mr. MULFORD. It might be 7 or 8 years. There are other countries that have had successful programs. Mexico's program, a 3-year program at the moment, has been highly successful. Chile had 3 or 4 years of programs and is now back in the private markets.

But I think, Senator, that the key point is that the collective problem represented by these countries during a period of international debt crisis, their imbalance as a group of nations, not just

one, but the whole of Latin America, other parts of the world, did represent a very serious risk to the international financial system.

That is the Fund's job, to address that kind of a problem, and they've done so quite successfully. But it is with a different group of countries and has involved individual programs, in some cases, with countries that have not been very successful.

Senator MACK. The last question that I have goes back again to the arrearages and the plan that has been developed.

You caught my attention as you were talking about the concessional terms, I guess, that would be earned by the country in arrears. It almost sounded like it was such an excellent program, the terms were so good, that it's conceivable somebody might be saying out there, gee, the thing I ought to do is in fact go ahead and allow myself to get into an arrearage situation and then I can participate in these very special concessional programs.

But just so that I make sure that I'm right on this, I think that you also said that this particular arrangement will only be available for these nine countries that are presently in arrears.

Mr. MULFORD. That's correct.

Senator MACK. I appreciate that position, but I would suggest to you that there is the possibility that people just won't believe that. I mean, I don't know that there's anything you can do about it, but the reality is that there could be people out there that say, well, this arrangement, while they're saying that it's only for these nine people——

Mr. MULFORD. Well, the program, as agreed, negotiated and in writing in the Fund, is only for those countries now in arrears. Countries that create arrears in the future do not have the right to benefit from that program. They will go immediately into the disciplinary elements of the program.

And second, I'd like to point out that the countries that are working their way out of arrears, that are in this program, they do not get concessional money during the right program. So they are getting no money concession advantage while they accumulate their rights.

The body of resources that ultimately funds their performance, when they've earned their rights, which are paper rights, they cash them in for money.

At that moment, that money comes to them and goes right back to the Fund to eliminate the arrears. There's no concessional money going to these countries at all at this time in this sense.

Senator MACK. Just concessional terms.

Mr. MULFORD. No, no concessional terms. What I meant to say was that the bodies of money are concessional. That is to say, they were created in the past for the purpose of making concessional loans to countries in good standing that are poor.

But there's no concessionality being given to the countries that are working their ways out of arrears during the period in which they accumulate rights. They don't get anything from the Fund until they've performed. And then they get a momentary resource to remove their arrears and then they're a member in good standing and they can approach the Fund on the regular basis for resources.

Senator MACK. Thank you. Thank you, Mr. Chairman.

Senator SARBANES. Are the Secretary of the Treasury and the President prepared to be personally involved in trying to obtain the acceptance by the Congress of this quota increase?

Mr. MULFORD. Yes.

Senator SARBANES. And you expect them to play an active role, if necessary, I take it?

Mr. MULFORD. Yes, I do.

Senator SARBANES. All right. I wanted to ask a question away from the Fund for a moment, on the exchange rates and interest rates.

When you testified before this subcommittee last month on the semiannual report on exchange rate policy, you indicated you thought that the speed with which the dollar was rising had not made the United States uncompetitive by this movement.

Since that testimony, the dollar has continued to rise, and I believe it's now appreciated about 25 percent against the German mark and almost 10 percent against the Japanese yen since February.

Do you still hold the view that the value of the dollar should not be a concern and that the United States will not see a deterioration in its competitive position because of the dollar's recent movement?

Mr. MULFORD. I don't know exactly what base period you're using for your figures. I guess it's January.

Is that right?

Senator SARBANES. Well, February, I think, but it may be January. The first part of this year.

Mr. MULFORD. Of course, it's always important to remember when various statements were made and what the conditions were at that moment in the market when the statements were made.

But I would say that we have not been concerned about the level of the dollar. We had from time to time a concern about the rate at which it was moving up and we said that from time to time.

But we do not believe that, at present levels, the United States will become uncompetitive.

Senator SARBANES. Was there discussion of the dollar at the G–7 meeting?

Mr. MULFORD. Yes, there was extensive discussion.

Senator SARBANES. And some concern about its——

Mr. MULFORD. Currencies. Not just the dollar, but all currencies.

Senator SARBANES. Did we express concern about the rising value of the dollar at that meeting?

Mr. MULFORD. We indicated that we did not have a concern about the present level of the dollar. But obviously, we are not anxious to see the dollar continuing to appreciate because at some point, it will impact our competitiveness. But we don't believe that——

Senator SARBANES. Was any agreement reached that steps would be taken if the dollar appreciated beyond its current point?

Mr. MULFORD. Well, we expressed in the communique the view that we would continue to cooperate closely in markets, taking account of the need for orderly markets and, if necessary, through appropriately concerted action in the exchange markets.

That statement was intended to express the view of ministers and governors about present conditions in the market, including the various currency levels.

Senator SARBANES. So you think you're at the point where if it continues to move, you're going to have to take action.

Mr. MULFORD. I didn't say exactly that. I said that we do not favor a continuous appreciation of the dollar.

Senator SARBANES. Well, we always put things in a much, sort of a rougher way here in the Congress than you do in the administration.

But isn't it fair to say that you're pretty much at the point where if the dollar continues to appreciate, you're going to have to take some action?

Mr. MULFORD. What I can't do, Mr. Chairman, is to identify a point because by doing that, I would be saying, this point, or some other particular point.

Senator SARBANES. You're worrying about this problem over the weekends, aren't you? You haven't dismissed it as a matter on your agenda.

I take it it's a matter that you sort of carry with you over the weekends and worry about.

Would that be fair to say?

Mr. MULFORD. I spent last weekend on an airplane and in a room in London, leaving noon on Saturday and getting back late Sunday night.

We continue to follow the markets very closely at all times.

Senator SARBANES. Well, Mr. Secretary, thank you very much for your testimony. It's a pleasure, as usual, to have you before the committee.

Mr. MULFORD. Thank you, Mr. Chairman. I was glad not to hear a stampede behind me a few minutes ago.

Senator MACK. They were quiet as they left. [Laughter.]

Senator SARBANES. The subcommittee adjourns. Thank you very much.

[Whereupon, at 11:45 a.m., the subcommittee was adjourned.]

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